Available online at www.sciencedirect.com

ScienceDirect

Procedia Economics and Finance 22 (2015) 88 – 94

Procedia Economics and Finance

www.elsevier.com/locate/procedia

2nd International Conference 'Economic Scientific Research - Theoretical, Empirical and Practical Approaches', ESPERA 2014, 13-14 November 2014, Bucharest, Romania

Challenges of bank lending in Romaniaon short, medium and long-term

Gheorghe Zaman[a,]*, George Georgescu[a]

[a]*The Institute of National Economy, Casa Academiei Române, Calea 13 Septembrie nr. 13, Bucharest, 050711, Romania*

Abstract

The research is devoted to the analysis of some challenges on short, medium and long-term bank lending in Romania, taking into consideration a series of economic and social criteria as well as different types of loans. At the same time, special attention should be paid to the post-accession into EU impact and to the financial and economic effects of the international crisis. The main results of the research are expected to point out the necessity of structural improvements in the field of long-term credits contributing to investments boosting as a vital prerequisite for Romania's economy sustainable development. Meanwhile it is worth mentioning the intensity and duration of the crisis in Romania compared with other developed and emerging EU member countries. As main directions for future researches resulting from our study the importance of improvements in monetary policy transmission channels, the credit sustainable re-launching, and growing market share for banks with domestic capital, including majority state-owned capital are highlighted.

Keywords: bank lending; international crisis; post-accession and crisis impact; monetary policy transmission channels; long-term credits; investments.

* Corresponding author. Tel.: 0040213182467.
E-mail address: gheorghezaman@ien.ro

doi:10.1016/S2212-5671(15)00230-0

1. Introduction

Enhancing factors for speeding up the economic development depends, often in a decisive manner, on the attraction of available financial resources, including financing investment by banking loans, and also of current economic activities and population.

From this point of view it is worth mentioning from the beginning that the top reasons for bank profitability and prudential norms in the field determines the orientation of lending to viable projects, sustainable and demonstrable, that provide sufficient guarantees regarding the compliance with due repayment of loans, minimizing the risk of default. As such, this financing mean is likely to encourage states / companies with a higher level of development/ competitiveness potential, thereby deepening imbalances in the case of emergent countries should be countered by adequate public investment policies from the central budget and / or local, and the promotion of foreign investments.

This study aims to analyze the degree of financial intermediation in Romania, its evolution and impact of EU accession and of the global financial crisis that started in 2008. The research is focus on structural changes in the volume of bank lending (lei and foreign currency-denominated, companies/households, maturity) in order to highlight the main features, trends and challenges of bank lending on short, medium and long-term.

Of particular importance in order to reveal the health of financial and banking system is to analyze the nonperforming loans situation and its implications on the chances of bank lending recovery in Romania. The study seeks to draw attention to the risk of continuing bank deleveraging by credit institutions with majority foreign capital, dominant at the level of the banking system and the need to increase the market share of banks with domestic capital, including with majority state-owned capital, in order to support the investment process in Romania that recently entered the decline.

Finally, the study aims to reveal the importance of monetary policy for reinvigorating bank lending and, in particular, the release of transmission channels of these policies, which currently obstruct the adequacy of interest rates charged by commercial banks to the central bank's reference interest rate.

2. Highlights of financial intermediation compared to other EU countries

In Romania, the level of financial intermediation is much lower compared to other countries. The total banking assets-to-GDP ratio stood below 70% in 2012, the lowest among the EU states taken into consideration (Table 1).

Table 1 Financial intermediation in Romania compared to other EU countries in 2012

- % -

Country	Banking assets/GDP	Loans/GDP	Deposits/GDP
Austria	315.50	112.44	104.66
Bulgaria	114.45	70.84	69.07
Czech Republic	125.86	55.35	75.04
France	397.38	105.99	95.35
Germany	311.12	98.09	118.86
Greece	228.23	118.30	86.66
Italy	269.52	112.19	95.70
Netherlands	415.79	177.98	149.38
Poland	93.05	53.72	52.83
Portugal	337.13	152.32	127.45
Slovakia	83.54	49.54	56.81
Slovenia	143.23	84.59	58.93
Spain	341.21	156.76	145.02
Hungary	114.26	53.85	48.63
EU-27	351.72	120.03	113.43
ROMANIA	68.93	38.44	33.58

Source*:* NBR, ECB (Statistical Data Warehouse)

Moreover, in Romania, the degree of financial intermediation has been in decline in recent years, as shown data presented in Table 2. Thus, if in pre-crisis year 2008, the banking assets accounted for 67.4% of GDP, after an increase in this share in 2009 and 2010, then there was a clear downward trend, reaching 66% in mid-2013. According to the latest data available from the central bank, at the end of 2013, this percentage was 57.6% (NBR, 2014, p. 74). The ratio between bank loans and deposits,calculated in nominal terms, has deteriorated in Romania, i.e. from over 130% in 2008 to about 110% in mid-2013, mainly due to the lowering of loans'share in GDP from 39.3% to 37.1% over a period facingalso with a declining GDP in real terms too.

Year	Banking Assets/GDP	Loans/GDP	Deposits/GDP
2008	67.37	39.30	30.00
2009	74.19	40.69	34.14
2010	75.00	40.75	34.52
2011	70.55	40.10	33.55
2012	68.90	38.44	33.58
2013*	66.04	37.15	33.50

Table 2 Financial intermediation in Romania during 2008 - 2013

- % -

* June
Source:NBR, data on monetary statistics

The drop in the financial intermediation in Romania witnesses the underutilization of this development financing factor, explaining in part, under the pressure of international crisis, the decline in economic activity after 2008, and the difficulties of recovery and economic relaunching in the post-crisis period. A vicious circle through the impact of credit contraction on investmentprocess was created, which in turn could not supportgrowth, the deterioration ofthe financial situation of many businesses inducing difficultiesinto the banking system by increasing the distresse credits and, under the circumstances of credit standardstightening, by the lending demand deficit (lack of bankable projects).

3. The contraction of bank lending in Romania

The global crisis has severely damaged the financial system, including the banking system in Romania, under the circumstances of Romanian economy weaknesses, entering decline in 2009 and 2010, with a slight recovery in recent years.

The data presented in Table 3 show that the total outstanding loans (in lei and in foreign currency expressed in domestic currency, comparable prices June 2014) to households, non-financial corporations and others (excluding the government sector) drop significantly, respectively to 215.4 billion lei at the end of June 2014, compared with 250.4 billion lei recorded at the end of the pre-crisis year 2008, representing a decrease of about 14% in real terms.

The breakdown of loans on currency did not witnessed major changes, after a decreaseof the share of lei-denominatedloans during the period 2008-2011 from 42.1% to 36.3%, in the period 2012-2014 this percentage increased to 42.4%,appearing to follow a favorable trend, but maintaining below the share of foreign currency-denominatedloans.

The contraction of bank lending, although in line with international trends, there registered a different intensity in Romania, mainly affecting the lei-denominated loans to households, whose share in total lei-denominated loans fell from 48.9 % in 2008 to 41.1% in mid-2014. In absolute terms, the lei-denominated loans to households fell by about 14 billion lei or 27.1% compared to 2008 (comparable prices June 2014). At the same time, an increase in the share of lei-denominatedloans to non-financial corporations, i.e. from 48.9% in 2008 to 56.7% in mid-2014 was recorded.

As for lei-denominatedloans to households, the most affected were those for consumption, whose share in the total of these loans decreased from 92.6% in 2008 to 62.7% in June 2014, the mortgage and/or real estate loans increasing their share from 4% in 2008 to 17.3% over the same period. In absolute terms, the lei-denominated households consumer loans decreased by about 24 billion lei, i.e. to less than half compared to 2008 (comparable prices June 2014).

Table 3 Breakdown of loans by currency and destination*

	2008	2009	2010	2011	2012	2013	2014
Total loans denominated in lei and in foreign currency** (lei million)	250,376.8	241,552.6	234,482.6	242,773.2	234,609.2	222,670.3	215,373.9
Loans breakdown	100.00	100.00	100.00	100.00	100.00	100.00	100.00
- lei-denominated	42.10	39.66	36.74	36.34	37.26	38.82	42.38
- foreign currency-denominated	57.90	60.34	63.26	63.66	62.74	61.18	57.62
Lei-denominated loans	100.0	100.0	100.0	100.0	100.0	100.0	100.0
- corporations	48.90	49.17	51.70	54.69	57.78	57.41	56.78
- households, of which:	48.90	48.65	46.37	42.82	40.34	40.49	41.11
- consumer	92.60	92.86	73.89	73.45	70.44	66.80	62.69
- mortgage and/or real estate	4.00	4.39	4.44	4.33	5.31	10.03	17.35
- other purposes	1.70	0.99	20.11	20.61	21.88	20.74	17.61
- others	2.20	2.18	1.93	2.49	1.88	2.09	2.11
Foreign currency-denominated loans	100.00	100.00	100.00	100.00	100.00	100.00	100.00
- corporations	46.90	47.55	49.30	50.47	50.04	47.85	47.30
- households, of which:	50.78	50.84	49.81	48.48	49.14	51.20	51.17
- consumer	61.42	59.91	56.97	52.36	48.26	44.24	42.39
- mortgage and/or real estate	33.02	36.65	41.30	46.01	50.20	54.37	56.18
- other purposes	4.94	2.79	1.29	1.13	1.09	0.96	0.92
- others	2.30	1.61	0.89	1.04	0.82	0.95	1.53

* outstanding amounts in December of each year. For2014, end of June.
** comparable prices June 2014 (based on CPI against December of respective years)
Source: own calculations based on NBR data.

The breakdown of foreign currency-denominatedloansdid notsuffered significant changes, the share of household loans maintaining at around 50% over the period, while the share of loans to non-financial corporationsat around 48%.

Regarding the foreign currency-denominated to households, similar to those of lei-denominated, a decrease in the share of consumer loans has been recorded i.e. from 61.4% in 2008 to 42.4% in mid-2014, increasing the share of mortgage and/or real estate loans i.e. from 33% to 56.2% over the same period.

The analysis of private sector loans breakdown by maturity, although highlights different situations for non-financial corporationsand households, are both unfavorable (Table 4). Thus, during 2011-2013, both lei-denominated and foreign currency-denominated corporate loans were mostly on short and medium term (around 80% and 60% respectively), the loans on long-term (on a period of more than three years), representing just less than half or even one-fifth of the total loans. It results that, in terms of lending, thenon-financial corporationsare focusing on funding activities on a shorter time horizon, sometimes speculative, and to a much lesser extent, on major long-term investment projects, which also means a low level of investor confidence in the prospects of the Romanian economydevelopment.

On the other hand, as for the households, during 2011-2013, some changes in the structure of lei-denominated loans by maturity were recorded, toward equalizing the share of short and medium-term loans with the one of long-term loans. The foreign currency-denominated loans to households remained dominated in proportion of 94% by the long-term loans, mostly related to mortgageand/or real estate, sometimes on a time horizon of 25-30 years, inducing major risks (mainly on the exchange rate) some of which have begun to materialize, both at the population and the banking system levels, a threat that will hangover for a long time on the economic and social prospects of Romania.

Table 4 Breakdown of loans to non-financial corporations and households by maturity*

- % -

Total lei-denominated loans	Years	Corporations total (100%)		Households total (100%)	
		Short and medium-term	Long-term	Short and medium-term	Long-term
	2011	78.22	21.78	37.30	62.70
	2012	80.02	19.98	44.86	55.14
	2013	80.45	19.55	49.30	50.70
Total foreign currency-denominated loans	2011	59.88	40.12	5.94	94.06
	2012	59.19	40.81	5.67	94.33
	2013	58.30	41.70	5.69	94.31

* outstanding amounts in December of each year. For2013, end of August
Source:NBR, data on monetary statistics.

4. Maintaining prohibitive bank crediting costs

One of the most important indicators of financing through bank crediting, with a stimulating or, on the contrary, an inhibitive impact, consists in the borrowing costs. According to the data presented in Table 5 a significant reduction in interest rates charged by credit institutions in 2014 compared to 2009 was recorded, particularly for lei-denominated loans i.e. with almost 10 percentage points in the case of non-financial corporationsandwith more than 8 percentage points in the case of households, both for the outstanding loans, as well as for the new ones.

The lowering of the interest rates on euro-denominated loans was less significant for both customer segments, namely by about 1 percentage point for non-financial corporationsand by about 2 percentage points forhouseholds.

Table 5 Interest rates of Romanian credit institutions in 2014 compared to 2009

- % p.a. -

Year	Lei-denominated loans				Euro-denominated loans			
	Outstanding		New business		Outstanding		New business	
	Corporations	Households	Corporations	Households	Corporations	Households	Corporations	Households
2009	16,06	17,11	15,40	16,58	5,97	7,65	5,92	6,06
2014*	6,73	10,14	6,39	8,17	4,65	5,32	4,26	5,45

*July
Source:NBR, Monthly Bulletin July 2014(Statistical section), p. 45-46.

Despite this reduction, under the circumstances of gradually cuts in the the central bank's monetary policy interest rates from 10.25% in January 2009 to 3.25% in August 2014 and 2.75% in November 2014, the current level of interest rates charged by commercial banks remains extremely high, both for new lei-denominated loans (over 6% for non-financial corporations and over 8% for the households) and euro-denominated loans (more than 4% for non-financial corporations and over 5% for the households, the latter even upper compared to the outstanding loan interest rate).

The spread of deposits/loans interest rates remained excessive, both in lei (5.1 p.p. for households and 4.1 p.p. for non-financial corporations) and euro (4.0 p.p. for households and 3.4 p.p. for non-financial corporations).

It is worth mentioning that, in the euro area, the ECB reference rate is virtually zero and the composite indicator of the borrowing costs of commercial banks loans to the corporate sector remains below 3% (ECB, 2014).

Comparing the interest rates of lei-denominated loans with the inflation rate, which currently fell to 1.2% (last 12 months average, according to National Institute of Statistics, 2014) hyper-real positive interest rates performed by the commercial banks come out.

It is obvious that the high costs of bank crediting severely restrict the access of companies, including SMEs,to financing economic activities. In fact, the last quarterly survey conducted by the central bank of Romania (NBR, June 2014) revealed that,because of high costs of financing (interests, commission, guarantees), to which the system bureaucracy is added, most companies do not use banking credits and many of those with contracted loans have plans to reduce theirindebtedness. Most of companies that would be interested in banking loans would apply for this financing means only at a very low cost i.e. up to a maximum interest rate of 3%, both for lei-denominated and foreign currency-denominatedloans.

Consequently, most of the economic actors are constrained to limit to their own financial means, the extent of attracting European funds by the companies in the financial exercise 2007-2013 being extremely low in the case of Romania (Zaman, Georgescu, 2014), which have a negative impact on investments and therefore on the sustainable development of the country.

5. Concluding remarks

The study has revealed a significant reduction of financial intermediation in Romania, that stood anyway at a low level compared to other European countries, and also the contracting of bank lending as one of the main factors that have contributed to the lack of consistency of the economic recovery in the post-crisis period, re-entering recession in 2014.

At the same time, a deterioration of bank profitability parameters (losses registered at the whole banking levelduring 2010-2012, followed by a slight recovery in 2013 and 2014)has been recorded, as well as the risk and prudential indicators (an alarming increase in non-performing loans to over 22% of the total outstanding loans at the end of April 2014, according to central bank data).

In this context, there arises the question to what extent the weaknesses of the banking system in Romania, as an emerging country, are influenced or even determined by the predominance of foreign capital (in excess of 80%), compared to much lower shares in the EU developed countries (3% in France, 4% in Germany, 7% in Spain, 9% in Italy, 10% in the Netherlands) and even in other emerging European countries (58% in Hungary, 62% in Poland, 74% in Bulgaria).

At international level, based on case studies of countries in Latin America, opinions on foreign banks participation are divided, some arguing toward its positive effects, especially in terms of efficiency and competitiveness (Barajas et al, 2000, Martinez brush and Mody, 2004), others to the negative ones, mainly as a consequence of high bank concentration in respective countries (Haber and Musacchio, Levy-Yeyati, 2007, Schulz, 2006).

In the EU, after experienced severe effects of the financial crisis from 2008-2009, the massive participation of foreign banks in emerging European countries has generated crossborder spillover effects and capital outflows (Avdjiev et al., 2012, p. 46), slowed down only by the Vienna initiative agreement in 2010, brokered by the IMF and EU (Allen, F. et al, 2011, p. 51).

The disintermediation and exposures reduction from the part of parent banks affected their subsidiaries in Romania (9.1 billion euros credit lines cuts from 2009 up to present), the contraction of credits being partially offset by the purchase of government bonds, considered more convenient and less risky.

In our view,under crisis circumstances, characterized by an unstable banking system dominated by foreign capital, the alternative would be to encourage the private domestic capital and to strengthen,bya significant capitalization, the two majority state-owned banks (CEC and Eximbank), as a basis for recoveringthe lei-denominatedlong-term lending, especially to corporate sector (see the study of Zaman, 2013).

A prerequisite for the success of this endevour is to reduce the interest rates charged by commercial banks by releasing the transmission channels of the central bankmonetary policy, increasing market competition and sanctioning the manipulation of interest rates.

In this manner, a context of reasonable marginsrelated to loans interest ratesdifferential, both compared to deposits andtoother EUcountries would be created, especially in the light of Union Bankingcreation that Romania intends to join before the adoption of euro (Isarescu, 2014), preventingcompanies to use the alternative of euro-denominated loans from abroad due to foreign banks lower borrowing costs compared toour country.

Under these circumstances, a sustainable recovery in bank lending in Romania depends, decisively,on the change in the concept of banking management from a narrow and limited vision regarding the system objectives, which systematically exacerbate modalities of maximizing profits in short-term, regardless of external costs and on the expenses of other economic sectors, into a new responsible approach on long-term horizon, based on the real economy state and participating as intrinsic partner to the country development.In order to address the function of the banking sytem as major player in financing economic activities, a more close involvement of banks in European funds absorption is expected to help viable investments projects implementation, representing also an opportunity to reinvigorate lending.

REFERENCIES

Allen, F., Becck T., Carletti, E., Lane, P. R., Schoenmaker, D ,Wagner, W., 2011. Cross-Border Banking in Europe: Implications for Financial Stability and Macroeconomic Policies, Centre for Economic Policy Research, London, UK.

Allen, F., Carletti, E., 2010. An Overview of the Crisis: Causes, Consequences and Solutions, International Review of Finance 10, 1-27.

Avdjiev, S., Kuti, Z., Takats, E, 2012. The euroarea crisis and cross-border bank lending to emerging markets, BIS Quarterly Review, December.

Barajas, A., Steiner, R., Salazar, N., 2000. The Impact of Liberalization and Foreign Investment in Colombia's Financial Sector, Journal of Development Economics 63(1), 157-196.

Darvas, Z., Wolff, G.B., 2013.Should non-euro area countries join the single supervisory mechanism, Bruegel Policy Contribution, Issue 2013/06, Brussels.

De Haas, R., Konniyenko, Y., Loukoianova, E., Pivovarsky, A., 2011. Foreign banks during the crisis: sinners or saints?, EBRD.

European Bank Coordination ("Vienna") Initiative, 2011. The Role of Commercial Banks in the Absorption of EU Funds,Report by the Working Group for discussion at the EBCI Full Forum Meeting, 16-17 March, Brussels.

European Central Bank, 2014. Press release: Euro Area MFI interest rate statistics: July 2014, Frankfurt, 3 September.

Illes, A., Lombardi, M., 2013. Interest rates pass-through since the financial crisis, BIS Quarterly Review, September.

Isărescu, M., 2014.Romania, euro adoption and Banking Union, International Conference ERMAS, UniversitateaBabeş-Bolyai, Cluj-Napoca, 18 August.

Haber, S., Musacchio, A., 2005. Contract Rights and Risk Aversion: Foreign Banks and the Mexican Economy, 1997-2000, Stanford University.

Levy Yeyati, E., Micco, A., 2007. Concentration and Foreign Penetration in Latin American Banking Sectors: Impact on Competition and Risk, Journal of Banking and Finance.

Martinez Peria, M. S. and Mody, A., 2004. How Foreign Participation and Market Concentration Impact Bank Spreads: Evidence from Latin America, Journal of Money, Credit, and Banking 36 (3), 511-537.

National Bank of Romania, 2014. Report on inflation, Year X, no 37, Bucharest, August.

National Bank of Romania, 2014. Annual Report 2013, Bucharest, June.

National Bank of Romania, 2014. Monthly Bulletin, Bucharest, June, July, August.

National Bank of Romania, 2014.Survey on the access to finance of thenon-financial companies in Romania and their capacity to cope with adversefinancial conditions, Bucharest, June.

National Bank of Romania, 2013. Financial Stability Report, Bucharest.

National Institute of Statistics, 2014. Press Release on CPI in August, no 218, Bucharest, 10 September.

Schulz, H., 2006. Foreign Banks in Mexico: New Conquistadors or Agents of Change? The Wharton School, Financial Institutions Center, Working Paper No. 06-11, University of Pennsylvania.

Zaman, Gh.,Georgescu, G., 2014. Structural and cohesion funds absorption in Romania. Balance of the 2007-2013 financial exercise and lessons for the current period, Romanian Journal of Economics, vol. 38, pp 49-88, June.

Zaman, Gh., 2013. Aspects and trends of crediting the Romanian economy in lei and foreign currency during the pre- and post-accession periods, Romanian Journal of Economics vol. 36, pp 5-29, June.